Written evidence from Dr Stefanie Reissner[1]

Public Administration and Constitutional Affairs Committee

Sourcing public services: Lessons to be learned from the collapse of Carillion inquiry

Introduction

The recent bankruptcy of Carillion has highlighted the risks associated with Private Finance Initiatives (PFIs). As reported to the Inquiry by Professor Demirag, these risks relate to the long timescale of PFIs, the size of private partner organizations (such as Carillion) and the number of contracts awarded to a single such partner.

In addition to large-scale PFIs, however, there is myriad of smaller Public-Private Partnerships (PPPs) across the country. These arrangements typically involve collaboration between local government and private partner organizations in the form of strategic partnerships or joint ventures. They are known as *institutionalized PPPs* and involve the transfer of local government staff into a new, usually privately-owned legal entity for a predefined time period (usually 10 years).

In a climate of austerity, by engaging in such PPPs local government seeks to receive managerial knowledge to increase organizational efficiency and effectiveness and to develop additional income streams (for example by providing back office services such as procurement and human resources to other organizations). In a competitive environment, private partner organizations seek to spread business risk via such long-term arrangements that provide a relatively predictable income stream while not requiring significant investment.

Yet, the challenges and risks of institutionalized PPPs are not widely known. There is little publicly available information on the governance of such entities and it seems that any decisions about creating them is within the realm of local government with little or no central oversight. Hence, in institutionalized PPPs it is largely unclear how the public sector manages the risk from suppliers (in this case strategic partners) throughout the life-cycle of outsourcing public services. In this reply to the Inquiry, I will outline the embedded risks to services and staff in institutionalized PPPs to complement the considerations of more overt risk in PFIs. It is hoped that it will contribute to a more comprehensive evaluation of risk in public-private service delivery.

[1] Dr Stefanie Reissner, Senior Lecturer, Newcastle University Business School, Newcastle University

The best of both worlds?

Institutionalized PPPs have been envisaged as bringing together the strengths of local government (such as operational expertise in providing public services to and in collaboration with local communities) and private partner organizations (such as managerial expertise and a focus on efficiency and effectiveness). There is an expectation that this combination benefits all stakeholders. Local communities are expected to benefit from extra resources for the local area (for example to alleviate social deprivation and support economic regeneration) and the shareholders of private partner organizations are expected to benefit from the profit made by the operations of institutionalized PPPs.

However, these expectations may be too idealistic. As Reissner's (2017) research[2] in an institutionalized PPP suggests, private working practices go against the grain of public service delivery. There was a strong sentiment among staff and in local newspaper coverage that, in contrast to the expectations of the private partner organization, local government should not make a profit from delivering public services to local communities and that the private partner organization's global shareholders should not benefit from any profits generated at local level. As such, there were multiple interpretations of what an institutionalized PPP is (or ought to be) and how it can (or ought to be) put into practice, which may distract from operational priorities. Yet, little is known about the effects thereof on the performance of institutionalized PPPs and the extent to which the levels of risk increase as a result.

Risks of organizational hybrids

Institutionalized PPPs combine the organizational form of local government and that of private organizations in a single entity. They are also known as organizational hybrids with an expectation that the integration of staff and working practices of local government and private partner organizations generate new ways of working. While these expectations can sometimes be met in practice, research has emphasized two main risks associated with such entities.

Firstly, in institutionalized PPPs the same action or outcome can be perceived as success by one set of stakeholders and as failure by another. For example, restructuring local government operations may be seen as a business success on the one hand because it reduces costs and provides finance for local government and communities. But on the other hand, the associated changes to staffing (typically leading to more precarious contracts or even redundancy) may be seen as failure to protect local staff. The expectations by different sets of stakeholders thus contribute to perceptions of failure regardless of events and outcomes, which is likely to affect staff morale and productivity and increase the risks associated with institutionalized PPPs.

[2] Financial support for this research by Economic and Social Research Council (ESRC) under award RES-061-25-0144-A is gratefully acknowledged.

Secondly, in institutionalized PPPs the structure and operations are often modelled on one of the partner organizations. At the outset, the expectation is that local government adopt private, profit-oriented working practices to alleviate some of the financial pressures resulting from austerity measures. However, institutionalized PPPs have been found to recreate local government structures and ways of working, failing to generate the promised efficiency savings and potentially increasing the risks associated with not meeting targets.

As such, there is a risk that institutionalized PPPs fail to achieve the expected benefits of the arrangement to the detriment of local government and communities. In a climate of austerity, many local government organizations rely on the financial benefits generated through collaboration with private partner organizations in terms of efficiency savings, additional income and other financial investments that may be part of the partnership contract, such as investment in infrastructure or employment. If institutionalized PPPs fail to generate such resources, local government may well have to cut frontline services that affect the most vulnerable constituents, risking further deprivation and social hardship.

Challenges and considerations for this Inquiry

Due to their long timeframe, it is largely unknown how effective institutionalized PPPs have been until they have come to an end with more such entities may having been created during that time. Yet, given the positive portrayal of such entities and the risks discussed above, it is pertinent that mechanisms be created to assess the benefits and risks of institutionalized PPPs at different points during their lifespan. For example, prior to the transfer of local government staff into a new legal entity, the terms of the partnership agreement, details about its scope and an independent assessment of projected benefits and risks for both parties and their respective stakeholders would provide stronger evidence for the rationale of such entities and the underlying business case. Further, the performance of institutionalized PPPs can be assessed through the definition of clear milestones to see whether promises about cost savings and job creation have been met. Such insights would provide important learning points for other local government organizations considering the creation of an institutionalized PPP.

Given that institutionalized PPPs are created by local government with little central oversight, it is difficult to share the benefits and risks associated with these entities more widely across the public sector. It is therefore pertinent that a methodology with appropriate evaluation criteria be developed through which the benefits and risks of these entities can be assessed. Good practice for such assessment may further be identified and formalized to generate comparable indicators across institutionalized PPPs.

Any such methodology and assessment ought to include non-financial factors. For example, Reissner and Pagan's (2013) research[3] indicates that former local government staff may permanently transfer from the institutionalized PPP into the private partner organization, risking 'brain drain' in local government once the institutionalized PPP has come to an end. To what extent is this already recognized as a risk and how does local government seek to mediate? Moreover, learning points need to be identified and shared to mitigate against any unexpected risks throughout the duration of institutionalized PPPs, which may result from incompatibility of a combination of the 'best of both worlds'.

Thus, the Inquiry may want to establish how institutionalized PPPs are governed locally, how risks are mitigated upon inception and throughout their duration, how the benefits of such entities can be assessed and how wider learning points can be identified and shared. The Inquiry may also want to consider whether lessons learned from the collapse of Carillion can be applied to institutionalized PPPs and how oversight of risk assessment can be achieved. The risks arising from the provision of public services by or in collaboration with private partner organizations are significant both for government (central and local) and for ordinary people in often vulnerable local communities. These risks need to be fully understood and effectively managed.

References

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[3] [3]Financial support for this research by Economic and Social Research Council (ESRC) under award RES-061-25-0144-A is gratefully acknowledged.